

**THE OFFICE OF REGULATORY STAFF
PRE-FILED TESTIMONY AND EXHIBITS
OF
CHRISTINA L. SEALE**



DECEMBER 20, 2007

DOCKET NO. 2007-319-W

**APPLICATION OF SOUTH ATLANTIC UTILITIES,
INCORPORATED FOR APPROVAL OF AN
INCREASE IN RATES AND CHARGES FOR THE
COMMUNITY WATER SYSTEM AT MAY RIVER
PLANTATION IN BLUFFTON, SOUTH CAROLINA**

PRE-FILED TESTIMONY OF CHRISTINA L. SEALE

FOR

THE OFFICE OF REGULATORY STAFF

DOCKET NO. 2007-319-W

IN RE: SOUTH ATLANTIC UTILITIES, INC.

Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.

A. My name is Christina L. Seale. My business address is 1441 Main Street, Suite 300, Columbia, South Carolina, 29201. I am employed by the South Carolina Office of Regulatory Staff ("ORS") as an Auditor.

Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND YOUR BUSINESS EXPERIENCE.

A. I received a Bachelor of Science in Accounting with a minor in Computer Systems and Applications from Columbia College in 2000. From 2001 to 2004, I was employed by the South Carolina Office of the State Auditor. In that capacity, I performed agreed-upon procedures engagements and statewide single audits of various state agencies in South Carolina. In January 2005, I began my employment with ORS, where I have been performing regulatory audits of utility companies, mainly water and wastewater utilities.

Q. WHAT IS THE PURPOSE OF YOUR PRE-FILED TESTIMONY INVOLVING SOUTH ATLANTIC UTILITIES, INC.?

1 A. The purpose of my pre-filed testimony is to set forth my findings and
2 recommendations resulting from ORS's examination of the Application of South
3 Atlantic Utilities, Inc. for approval of an increase in rates and charges for the
4 community water system at May River Plantation in Bluffton, South Carolina filed
5 on September 4, 2007 ("Application"). My testimony will refer to May River
6 Plantation subdivision ("May River"), the only system of South Atlantic Utilities,
7 Inc. ("South Atlantic", "SAU" or the "Applicant") operating in South Carolina.

8 **Q. PLEASE IDENTIFY THE EXHIBITS ATTACHED TO YOUR PRE-FILED**
9 **TESTIMONY.**

10 A. I have attached the following exhibits to my pre-filed testimony relating to the
11 Application:

- 12 ▪ Audit Exhibit CLS-1: Operating Experience and Operating Margin for May
13 River Plantation
- 14 ▪ Audit Exhibit CLS-2: Explanation of Adjustments for May River Plantation
- 15 ▪ Audit Exhibit CLS-3: Computation of Depreciation and Amortization
16 Expenses for May River Plantation
- 17 ▪ Audit Exhibit CLS-4: Computation of Income Taxes for May River
18 Plantation

19 These exhibits were either prepared by me or were prepared under my direction and
20 supervision in compliance with recognized accounting and regulatory procedures
21 for water utility rate cases. These exhibits show various aspects of May River's
22 operations and financial position.

1 **Q. PLEASE DESCRIBE THE FORMAT OF AUDIT EXHIBIT CLS-1 AND**
2 **ELABORATE ON THE CALCULATIONS.**

3 A. Audit Exhibit CLS-1 shows May River's operating experience and operating margin
4 for water operations for the test year ended December 31, 2006. The exhibit's format
5 is designed to reflect the Application per books and ORS's proposed accounting and
6 pro forma adjustments necessary to normalize the results of May River's test year
7 operations.

8 Column (1) shows the Application per books calculated by SAU for the test year
9 ended December 31, 2006. The net operating loss for return of (\$1,255) was based
10 on total operating revenues of \$9,451 less total operating expenses of \$10,706. The
11 operating margin of (13.28%) was calculated by dividing the net operating loss for
12 return by the total operating revenues.

13 Column (2) shows ORS's proposed accounting and pro forma adjustments designed
14 to normalize the Application per books. An explanation of each adjustment is
15 contained in Audit Exhibit CLS-2.

16 Column (3) shows ORS's result of a normalized test year for May River by adding
17 columns (1) and (2). The net effect of ORS's proposed accounting and pro forma
18 adjustments resulted in net operating loss of (\$1,058) and an operating margin of
19 (11.96%).

20 Column (4) shows Applicant's proposed increase recalculated by ORS and the
21 calculation of taxes associated with the proposed increase. An explanation of each
22 adjustment is contained in Audit Exhibit CLS-2.

Column (5) shows the effect of the Applicant's proposed rate increase by adding columns (3) and (4). The net effect after the Applicant's proposed rate increase resulted in net operating income for return of \$3,357 and an operating margin of 23.82%.

Q. PLEASE EXPLAIN THE ADJUSTMENTS IN AUDIT EXHIBIT CLS-2.

A. The following adjustments are listed at Audit Exhibit CLS-2 under "Adj. #". For comparative purposes, ORS and Applicant's adjustments are both presented in Audit Exhibit CLS-2.

Adjustment 1 - The ORS Water/Wastewater Department proposes to normalize customer billings for the test year. Details of these adjustments are shown in the pre-filed testimony of ORS Water/Wastewater Specialist, Elizabeth Ford.

Adjustment 2 - The ORS Water/Wastewater Department proposes to remove tap fees of (\$500) from revenues and include in Contributions in Aid of Construction ("CIAC"). These fees are shown on Audit Exhibit CLS-3 under additional CIAC amortized by ORS.

Adjustment 3 - ORS proposes to remove charitable donations paid during the test year of (\$24).

Adjustment 4 - ORS proposes to remove (\$600) of meter reading expenses, which are already included in the overhead allocation. Meter reading is a service provided by SAU's administrative and operator services company, Water Utility Management, LLC.

Adjustment 5 - ORS proposes to adjust the gross receipts taxes associated with the revenues after accounting and pro forma adjustments. Total gross revenues after

1 accounting and pro forma adjustments were multiplied by the PSC and ORS factor
2 of .0071856.

3 Adjustment 6 - ORS proposes to remove (\$200) from the Licenses Account for
4 expenses that were not supported by adequate documentation.

5 Adjustment 7 - ORS proposes to add license fees of \$85 paid in the test year, which
6 were not included in the cost of service.

7 Adjustment 8 - ORS proposes to adjust depreciation and amortization on all fixed
8 assets and CIAC as of December 31, 2006 to reflect useful lives determined by the
9 ORS Water/Wastewater Department. ORS calculated total depreciation expense of
10 \$3 (Net depreciation expense of \$63 less total CIAC of \$60) and reduced it by the
11 Application per book depreciation expense of \$275 for a total adjustment of (\$272)
12 as shown on Audit Exhibit CLS-3.

13 Adjustment 9 - ORS proposes to remove lab fees of (\$90) incurred outside the test
14 year, but included in the cost of service.

15 Adjustment 10 - ORS proposes to adjust total South Atlantic overhead expenses of
16 \$907,612 to calculate total allowed shared expenses allocable to May River. ORS
17 removed \$392,183 from total overhead, which consisted of May River direct
18 expenses, expenses for other subdivisions that are not shared with May River,
19 nonallowables, and expenses that were not supported by adequate documentation.
20 ORS Water/Wastewater Department determined that .75% was an appropriate factor
21 for the allocation of overhead expenses. ORS proposes to include .75% of the total
22 allocable overhead expenses of \$515,429 (\$907,612 - \$392,183) for May River of

1 \$3,866 for the test year. Total allocable overhead expenses of \$3,866 less the
2 Application per book amount of \$6,999 equates to a total adjustment of (\$3,133).
3 Adjustment 11 - ORS proposes to include the amortization of rate case expenses in
4 the test year expenses. ORS adjusted for actual rate case expenses documented as of
5 November 30, 2007 of \$10,305. This amount is amortized over a three-year period
6 for an adjustment of \$3,435.

7 Adjustment 12 - Per the Application, South Atlantic proposed a rate increase in
8 customer billings of \$4,583. Based upon ORS Water/Wastewater Department
9 calculations, May River's proposed rates would produce additional revenues of
10 \$5,252. Details of these adjustments are shown in Ms. Ford's pre-filed testimony.

11 Adjustment 13 - ORS proposes to adjust gross receipts taxes associated with the
12 revenues after the proposed increase. ORS multiplied the total gross revenues after
13 the proposed increase by the gross receipts factor described in Adjustment 5.

14 Adjustment 14 - ORS proposes to adjust income taxes associated with the proposed
15 rate increase. See Audit Exhibit CLS-4 for the computation of income taxes.

16 **Q. PLEASE DESCRIBE THE REMAINING AUDIT EXHIBITS.**

17 A. Audit Exhibit CLS-3 shows the computation of depreciation and amortization
18 expenses. Depreciation and amortization expenses were annualized by using useful
19 lives determined by the ORS Water/Wastewater Department. Audit Exhibit CLS-4
20 shows the computation of the state and federal income taxes based on taxable income
21 after ORS's proposed accounting and pro forma adjustments and after the
22 Applicant's proposed increase recalculated by ORS. A state tax rate of 5% and the
23 federal tax rate of 15% were used to calculate the income taxes.

1 **Q. DOES THE APPLICANT MAINTAIN ITS BOOKS AND RECORDS IN**
2 **ACCORDANCE WITH PSC RULES AND REGULATIONS?**

3 A. No. The Applicant does not utilize the National Association of Regulatory Utility
4 Commissioners ("NARUC") Uniform System of Accounts for Water Utilities. In
5 the Applicant's last rate case, the Commission ordered SAU to maintain its books
6 and records in accordance with the NARUC Uniform System of Accounts. See
7 Commission Order No. 92-1037 dated December 16, 1992, Docket No. 91-494-W.
8 Furthermore, 26 S.C. Code Regs. 103-517 and 103-719 require water utilities to
9 maintain their books and records in accordance with the NARUC Uniform System of
10 Accounts. During our examination, ORS found several issues pertaining to the
11 Applicant's record keeping. South Atlantic does not maintain separate books and
12 records for May River's direct expenses, including continuing property records, and
13 complete books and records were not available at the time of the audit. Additionally,
14 supporting documentation such as receipts, invoices, contracts, leases, etc. were not
15 maintained for some of SAU's expenses. Also, there were several instances where
16 SAU made duplicate expense payments. ORS understands that the Applicant is still
17 in the process of attempting to locate, and provide to ORS, supporting documentation
18 to verify additional operating expenses.

19 **Q. BASED ON THE ABOVE CONCERNS, DOES ORS HAVE ANY**
20 **RECOMMENDATIONS FOR THE APPLICANT?**

21 A. Yes. ORS recommends that the Applicant establish a system of accounting controls
22 and maintain separate books and records for May River, including continuing
23 property records. Keeping these expense records separate from the non-regulated

1 utilities will help SAU comply with regulatory requirements. Also, ORS
2 recommends that South Atlantic establish, maintain and document contractual
3 agreements with each of its affiliates. In addition, ORS recommends that the
4 Applicant be required to maintain May River's books and records in accordance
5 with the NARUC Uniform System of Accounts for Water Utilities.

6 **Q. WHAT IS THE RESULTING OPERATING MARGIN AFTER APPLYING**
7 **ORS'S CALCULATION OF THE APPLICANT'S PROPOSED RATE**
8 **INCREASE?**

9 A. Based on ORS's proposed accounting and pro forma adjustments and after the
10 Applicant's proposed increase recalculated by ORS, the resulting operating margin is
11 23.82%, as shown on Audit Exhibit CLS-1.

12 **Q. DOES THIS CONCLUDE YOUR PRE-FILED TESTIMONY?**

13 A. Yes.

South Atlantic Utilities, Inc.
Docket No. 2007-319-W
Operating Experience and Operating Margin for May River Plantation
For the Test Year Ended December 31, 2006

| | (1) | (2) | (3) | (4) | (5) |
|--|--------------------------|---|--|---|--|
| | Application Per Books | ORS's Proposed Accounting & Pro forma Adjustments | After ORS's Proposed Accounting & Pro forma Adjustments | Applicant's Proposed Increase Recalculated by ORS | After Applicant's Proposed Increase Recalculated by ORS |
| <u>Operating Revenues</u> | | | | | |
| Customer Billings | \$ 8,951 | \$ (107) (A) | \$ 8,844 | \$ 5,252 (K) | \$ 14,096 |
| Tap Fees | 500 | (500) (B) | 0 | 0 | 0 |
| <u>Total Operating Revenues</u> | \$ 9,451 | \$ (607) | \$ 8,844 | \$ 5,252 | \$ 14,096 |
| <u>Operating Expenses</u> | | | | | |
| Electricity | \$ 804 | \$ (24) (C) | \$ 780 | \$ 0 | \$ 780 |
| Meter Reading | 600 | (600) (D) | 0 | 0 | 0 |
| Taxes Other Than Income | 69 | (5) (E) | 64 | 37 (L) | 101 |
| Licenses | 200 | (115) (F) | 85 | 0 | 85 |
| Depreciation | 275 | (272) (G) | 3 | 0 | 3 |
| Lab Fees | 870 | (90) (H) | 780 | 0 | 780 |
| Drinking Water | 889 | 0 | 889 | 0 | 889 |
| Overhead Allocation | 6,999 | (3,133) (I) | 3,866 | 0 | 3,866 |
| Rate Case | 0 | 3,435 (J) | 3,435 | 0 | 3,435 |
| Income Taxes (State and Federal) | 0 | 0 | 0 | 800 (M) | 800 |
| <u>Total Operating Expenses</u> | \$ 10,706 | \$ (804) | \$ 9,902 | \$ 837 | \$ 10,739 |
| <u>Net Operating Income (Loss) for Return</u> | \$ (1,255) | \$ 197 | \$ (1,058) | \$ 4,415 | \$ 3,357 |
| <u>Operating Margin</u> | <u>-13.28%</u> | | <u>-11.96%</u> | | <u>23.82%</u> |

South Atlantic Utilities, Inc.
Docket No. 2007-319-W
Explanation of Adjustments for May River Plantation
For the Test Year Ended December 31, 2006

| Revenues and Expenses | Adj.# | Description | \$ ORS | \$ Applicant |
|---|-------|--|-----------|-----------------|
| <u>ORS's Proposed Accounting and Pro forma Adjustments</u> | | | | |
| (A) Customer Billings | 1 | To normalize customer billings for the test year. | (107) | 0 |
| (B) Tap Fees | 2 | To remove tap fees from revenues and include in CIAC. | (500) | 0 |
| (C) Electricity | 3 | To remove donations paid in the test year. | (24) | 0 |
| (D) Meter Reading | 4 | To remove meter reading expenses, which are included in the overhead allocation. | (600) | 0 |
| (E) Taxes Other Than Income | 5 | To adjust the gross receipts taxes associated with ORS's accounting and pro forma adjustments. | (5) | 0 |
| (F) Licenses | 6 | To remove unsupported expenses from the Licenses Account. | (200) | 0 |
| | 7 | To include license fees paid in the test year. | 85 | 0 |
| | | Total | (115) | 0 |
| (G) Depreciation | 8 | To adjust depreciation and amortization on all fixed assets and CIAC. | (272) | 0 |
| (H) Lab Fees | 9 | To remove lab fees incurred outside the test year, but included in the cost of service. | (90) | 0 |
| (I) Overhead Allocation | 10 | To adjust for an allowable expense allocation for ratemaking purposes. | (3,133) | 0 |
| (J) Rate Case | 11 | To amortize total rate case expenses over a three-year period. | 3 435 | 0 |
| <u>Applicant's Proposed Increase Recalculated by ORS</u> | | | | |
| (K) Customer Billings | 12 | To adjust customer billings for ORS's calculation of the proposed rate increase. | 5,252 | 4,583 |
| (L) Taxes Other Than Income | 13 | To adjust gross receipts taxes associated with the proposed rate increase. | 37 | 0 |
| (M) Income Taxes (State and Federal) | 14 | To adjust income taxes associated with the proposed rate increase. | 800 | 0 |

South Atlantic Utilities, Inc.
Docket No. 2007-319-W
Computation of Depreciation and Amortization Expenses for May River Plantation
For the Test Year Ended December 31, 2006

| Year Acquired | Description | Amount \$ | Service Life years | Rate % | Expense \$ |
|--|---|-----------------|--------------------------|-----------|---------------|
| <u>Fixed Assets Per Prior Rate Case Docket No. 91-494-W:</u> | | | | | |
| 1973 | May River and Improvements | 500 | N/A | N/A | 0 |
| | Land | 1,000 | 50 | 2.00% | 20 |
| | Building | 1,427 | 50 | 2.00% | 29 |
| | Water Tank | 4,968 | 5 | 20.00% | FD |
| | Pump and Equipment | 4,471 | 10 | 10.00% | FD |
| | Miscellaneous Equipment | 12,366 | | | 49 |
| | Totals | | | | |
| <u>Additional Fixed Assets Per Application:</u> | | | | | |
| 1992 | Meters | 273 | 20 | 5.00% | 14 |
| | Total Fixed Assets & Depreciation Expense | 12,639 | | | 63 |
| <u>CIAC Per Prior Rate Case Docket No. 91-494-W:</u> | | | | | |
| 1973-1991 | Tap Fees Paid By Developer | (8,300) | 8.31 | 12.04% | FA |
| 1973-1991 | Availability Fees | (4,066) | 8.31 | 12.04% | FA |
| | Totals | (12,366) | | | 0 |
| <u>Additional CIAC Amortized by ORS:</u> | | | | | |
| 2006 | Tap Fee | (500) | 8.31 | 12.04% | (60) |
| | Total CIAC & Amortization Expense | (12,866) | | | (60) |
| | Net Depreciation Expense | | | | 3 |
| | Less: Per Book Depreciation Expense | | | | (275) |
| | ORS's Proposed Depreciation Expense Adjustment | | | | (272) |

FD= Fully Depreciated
FA= Fully Amortized
N/A= Not Applicable

South Atlantic Utilities, Inc.
Docket No. 2007-319-W
Computation of Income Taxes for May River Plantation
For the Test Year Ended December 31, 2006

| | After ORS's Proposed Accounting & Pro forma Adjustments | After Applicant's Proposed Increase Recalculated by ORS |
|---|--|--|
| Total Operating Revenues | \$ 8,844 | \$ 14,096 |
| Less: Operating Expenses | <u>9,902</u> | <u>9,939</u> |
| State Taxable Income | (1,058) | 4,157 |
| Less: State Income Taxes @ 5% | <u>0</u> | <u>208</u> |
| Federal Taxable Income | (1,058) | 3,949 |
| Federal Income Taxes: | | |
| 1st \$50,000 @ 15% | 0 | 592 |
| Total State and Federal Income Taxes | 0 | 800 |
| Less: Income Taxes after ORS's Proposed Accounting and Pro forma Adjustments | <u>0</u> | <u>0</u> |
| ORS's Income Taxes (State and Federal) Adjustment | <u>\$ 0</u> | <u>\$ 800</u> |